

ATTACHMENT 2

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September 27, 2010

Letter of Appeal

High Cost and Low Income Division

Universal Service Administrative Company

2000 L Street NW, Suite 200

Washington, DC 20036

Re: High Cost Appeal, Chariton Valley Telephone Corporation Letter of Appeal of High Cost Audit, and USAC Management Response thereto, Chariton Valley Telephone (SAC 421864) Audit Report HC-FL-121, Follow-Up Audit to HC-2008-206.

Dear USAC High Cost and Low Income Division:

Pursuant to USAC's July 28, 2010 Notice of Results of the above referenced Audit, Follow-Up Audit, and USAC Management Response thereto, and pursuant to USAC's July 30, 2010 Notice of Action to be taken pursuant to the above referenced audit proceedings, Chariton Valley Telephone Corporation hereby appeals the USAC determinations pursuant to the "Option A" appeal.¹

Chariton Valley's contact person who can most readily discuss the appeal with USAC is:

Tina Jordan

Director of Finance

Chariton Valley Telephone Corporation

1213 E. Briggs Dr

Macon, MO 63552

(660) 395-9682

¹ The July 28, 2010 Notice of Results was received by Chariton Valley August 2, 2010. The July 30, 2010 Notice of Action to be taken was received by Chariton Valley on August 4, 2010. Mr. Robert Binder's email of September 9, 2010 stated that the "60 day clock" for an Option A appeal started on July 30, 2010.

tjordan@charitonvalley.com

Other persons available to discuss this appeal are:

James Simon
General Manager
Chariton Valley Telephone Corporation
1213 E. Briggs Dr
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and

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Chariton Valley Telephone Corporation's Study Area Code is SAC 421864. The audit period in question is July 1, 2007 through June 30, 2008. The audit report of Grant Thornton is dated April 30, 2010. The USAC Management response to the recommendation of Grant Thornton is dated June 4, 2010. Chariton Valley is appealing the decision that its assignment of certain computer services costs was not compliant with FCC rules, and resulted in excess funding in the total amount of \$304,653.

Audit Finding

The Grant Thornton (GT) audit report found the Beneficiary failed to use an appropriate method of cost allocation to distribute corporate computer and network service expenses to Chariton Valley Telephone Corporation (CVTC) which led to an over allocation of computer services (Account 6124) expenses to CVTC. GT stated:

“the Beneficiary used revenue and net income which are not appropriate cost drivers to allocate computer service expense to Chariton Valley Wireless Services, Chariton Valley Long Distance, Chariton Valley Telecom Corporation, Chariton Valley Communications Corporation and CVTC”.

GT cited FCC rules 47 CFR 32.37(c), 47 CFR 64.901(3)(iii) for support for its position.

GT performed a “reallocation” of nine categories of corporate computer and network service expenses assigned by CVTC, and concluded that CVTC over-reported computer service expense resulting in excess funding of \$225,332 in High Cost Loop and \$79,321 in Interstate Common Line Support funding.

The GT audit report set forth CVTC’s Beneficiary Response:

“The Beneficiary has used an allocation method which is acceptable and appropriate and does not agree with the auditor on this item”.

The GT audit report then set forth GT’s response to the Beneficiary Response. GT’s response stated;

“The computer services expenses were allocated using a ratio of the average of annualized revenue and annualized net income. If the subsidiary had a net loss, the net income was considered zero and expenses were not taken into consideration. Per the FCC rules surrounding affiliate transactions and allocation of costs, it would not be appropriate for the Beneficiary to use Revenue and Net Income as factors in the determination of allocation percentages. When neither direct nor indirect measures of cost allocation can be found, the cost category shall be allocated based upon a general allocator computed by using the ratio of all expenses directly assigned or attributed to regulated and non-regulated activities.”

The June 4, 2010 USAC Management Response concurred with the auditor.

Controlling Rules

47 CFR 64.901(3) provides, with respect to allocating costs between regulated and non-regulated activities, that common costs (those which cannot be directly assigned to either regulated or non-regulated activities) shall be allocated between regulated and non-regulated activities in accordance with the following hierarchy:

- i. when possible, based upon “direct analysis of the origin of the costs”;
- ii. when direct analysis is not possible, based upon “indirect, cost-causative linkage to another cost category (or group of cost categories) for which direct assignment or allocation is available”;
- iii. when neither direct nor indirect measures can be found, based upon a “general allocator computed by using the ratio of all expenses directly assigned or attributed to regulated and non-regulated activities”.

Chariton Valley's Appeal of the Audit Findings

CVTC is not in agreement with GT's conclusion. The indirect assignment of costs method utilized by CVTC for the nine categories of costs in dispute was appropriate.

Chariton Valley Telephone Company (Beneficiary "CVTC") and five affiliates all utilized corporate network and computer services for the audit year in question.² CVTC structured network and computer services costs so that computer service costs were borne by an affiliated company in order to keep deregulated costs out of CVTC's cost support calculation. The controlling FCC rules have a first preference for direct assignment, a second preference for indirect assignment, and a general allocator is to be used only when direct or indirect assignment is not available. CVTC either directly or indirectly assigned all costs. CVTC utilized no "general allocator".

CVTC's direct and indirect assignment is set forth in Exhibit One attached hereto. CVTC's cost assignment factors are found at tab "July05". GT's "reallocation" is set forth as Exhibit Two attached hereto. GT's reallocation percentages are found at tab "Jan05-June05".

GT's Exhibit Two is substantially similar to CVTC's Exhibit One. GT used CVTC's Exhibit One as the starting point upon which GT performed its reallocation. GT took no exception to the cost categories created by CVTC in Exhibit One, and took no exception to the cost category inputs. GT took no exception to the CVTC cost assignments for 17 of the 26 cost categories.

There is no dispute between CVTC and GT as to the identity and number of affiliates that CVTC assigned costs between, as to the three categories of computer service expense, Hardware, Software, and Variable Costs, or as to the cost amounts entered for each category account. All cost categories and category amounts included in both CVTC's Exhibit One and GT's Exhibit Two were subjected to full testing, and were accepted by GT.

There is no dispute as to the propriety of CVTC's direct assignment of those hardware and software costs for which the hardware or software was dedicated to the use

² Chariton Valley Communications Corp. (CVC) was in the cable TV business. Chariton Valley Central Mobilphone (CVCMP) was in the paging business. Chariton Valley Long Distance (CVLD) was in the long distance and internet business. Missouri RSA 5 Partnership d/b/a Chariton Valley Wireless (CVWS) was in the commercial mobile radio or cellular business. Chariton Valley Telecom Corp. (TCOM) was a CLEC.

of a single affiliate. There is no dispute as to CVTC's indirect assignment of hardware, software, and variable costs that were shared between two affiliates. There is no dispute as to assignment of costs shared by three or more affiliates for those cost categories where CVTC's "Subs/Revenue" assignment factor was utilized. There is no dispute as to CVTC's assignment of accounting/software costs between six affiliates utilizing the "Rev" assignment factor. There is no dispute as to CVTC's assignment of software and hardware support between six affiliates utilizing the "Revenue/Net Income" assignment factor.

The dispute exists only with respect to nine cost categories. CVTC has highlighted these nine cost categories on Exhibit Two for ease of reference.³ For these nine cost categories, CVTC used an indirect cost assignment factor described on both Exhibit One and Exhibit Two as "Revenue/Net Income". For these nine cost categories GT reallocated using a general allocator in preference to CVTC's indirect cost assignment factor.

CVTC's indirect assignment factor complied with the FCC rule, as it was a cost-causative linkage.

For these nine cost categories, CVTC's indirect assignment factor was denominated "Revenue/Net Income". CVTC's Revenue/Net Income factor complied with the requirement of 47 CFR 64.901(3)(ii) that it be an "indirect, cost-causative linkage".

For these nine hardware, software, and variable cost categories, CVTC was the predominant cost driver. CVTC would have had to purchase these systems if it had no affiliates. The affiliates used the computer network.

The most appropriate, obvious, and available indirect linkage to ascertain cost proportions is revenue. The primary purpose of computer systems is to collect, maintain, and segregate the information necessary to track usage of CVTC's network. The computer system must measure usage and convert those measurements into billing for use of CVTC's network, either by local end-users, or by carriers accessing CVTC's

³ These nine cost categories are: Omnia Server, Financial Server, CVTC-WAN, CVTC-LAN, Hardware Lease, Omnia Software Non Wireless, Software Omnia/Solomon, Software/Hardware Support-CVT, and Software/Hardware Expenses.

⁴ In addition, a significant proportion of computer service resource utilization is associated with performing the part 32 and 64 accounting requirements, and the cost separation requirements of being a USF cost company. Only CVTC should bear that additional proportion.

network. CVTC's carrier access revenues constitute a significant portion of all revenues. With such a large percentage of revenue being generated from access, access is the main linkage to the costs associated with the corporate network and computer services which provide the ability to bill and collect that revenue. CVTC's local revenues also constitute a significant portion of revenues.⁴

CVTC's Revenue/Net Income factor included consideration of net income. This was an effort to allow for direct expenses. To preclude artificial expense overstatement for affiliates showing a net loss, a minimum net income threshold of zero, or no net loss, was established. This minimum threshold resulted in less costs being assigned to CVTC than if net losses had been included.

For these nine cost categories, CVTC's indirect assignment of costs was appropriate. CVTC's allocations were in compliance with FCC rules. For these nine cost categories an indirect measure could be found, and was proper to use.. A general allocation should not have been used by GT, as indirect cost assignment was available.

GT's general reallocation did not comply with the FCC rule, and was not consistently applied.

A general allocation is only to be used when no direct or indirect assignment is available. Even where its use is appropriate, a general allocation is to be computed using the ratio of all expenses directly assigned or attributed to regulated and non-regulated activities.

On Exhibit Two, tab "Jan05-Jun05, GT inserted a "% of total expense calc. by GT". This calculation resulted in CVTC being assigned 39% of the total expenses of all affiliates. GT then used this 39% to "reallocate" the 9 disputed cost categories.

CVTC has not been able to ascertain the GT inputs resulting in its 39% reallocation. It does not appear to be an attempt to allocate based on any ratio of all expenses directly assigned to regulated and non-regulated activities.

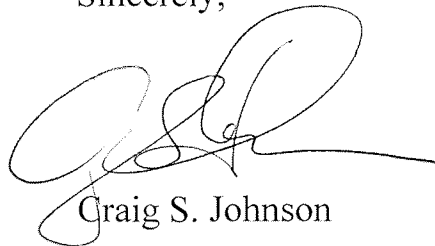
CVTC disagrees that GT's 39% represents a reasonable approximation of CVTC's share of total computer service expenses. CVTC knows that its share of computer expenses exceeds 39%. If CVTC were to assign computer service costs based solely on direct labor costs, another potential indirect cost linkage, CVTC's share would be 72%, as its direct labor costs are 72% of the direct labor costs of CVTC and all affiliates. This 72% is much closer to the assignment produced by CVTC's Revenue/Net Income factor than GT's reallocation, and is more representative of CVTC's appropriate share. There is simply no basis in reality for GT's 39%.

Not only was use of the reallocation factor inappropriate, GT was inconsistent in applying it. Tab "Comp Svc Sep04" to Exhibit 2 was the support worksheet provided by CVTC to GT. In column H of this tab CVTC has inserted either an "E", meaning that cost category was taken exception to by GT, or an "OK", meaning that cost category was not taken exception to by GT. Rows 54-57 sets forth four of the disputed cost categories. GT took exception to rows 55 and 56 (Software and Hardware Support and expenses), but did not take exception to rows 54 and 57 (Software and Hardware Support). GT was not consistent in applying its "reallocation" percentage to the same cost categories CVTC applied its Revenue/Net Income factor to.

Conclusion

Wherefore, on the basis of the foregoing, USAC is respectfully requested to reverse the GT audit finding, and the USAC Management Response, find that CVTC's indirect cost assignment for the 8 cost categories complied with 47 CFR 64.901(3), reverse the conclusion that CVTC over-reported computer service expense resulting in excess funding of \$225,332 in High Cost Loop and \$79,321 in Interstate Common Line Support funding, and reinstate CVTC's right to reimbursement of those costs.

Sincerely,

A handwritten signature in black ink, appearing to read "CS Johnson", with a large, stylized loop at the end.

Craig S. Johnson

cc: James Simon
Tina Jordan